STAT

OFFICE OF THE SECRETARY OF THE TREASURY

WASHINGTON, D.C. 20220

September 16, 1982

82-5924/3

UNCLASSIFIED
(WITH SECRET ATTACHMENT)

MEMORANDUM FOR THE VICE PRESIDENT
THE SECRETARY OF STATE
THE SECRETARY OF DEFENSE
THE SECRETARY OF AGRICULTURE
THE SECRETARY OF COMMERCE
THE ATTORNEY GENERAL
THE DIRECTOR, OFFICE OF MANAGEMENT AND BUDGET
CHAIRMAN, COUNCIL OF ECONOMIC ADVISORS
ASSISTANT TO THE PRESIDENT FOR NATIONAL SECURITY AFFAIRS
ASSISTANT TO THE PRESIDENT FOR POLICY DEVELOPMENT
UNITED STATES TRADE REPRESENTATIVE
DIRECTOR OF CENTRAL INTELLIGENCE

SUBJECT Senior Interdepartmental Group on International Economic Policy (SIG-IEP)

Attached please find comments prepared by Commerce (received at noon today) respecting negotiating strategy discussions with Europeans on pipeline sanctions for the Sig-IEP meeting today at 4:00 p.m.

David E. Pickford

David E. Pickford
Executive Secretary

Attachments

UNCLASSIFIED
(WITH SECRET ATTACHMENT)

SECRET

September 15, 1982
COMMERCE/TRADE ADMINISTRATION

NEGOTIATING STRATEGY
DISCUSSIONS WITH EUROPEANS
ON PIPELINE SANCTIONS

U.S. strategy for resolving the sanctions impasse while achieving our objectives should be implemented in two steps:

Step I -- Policy Clarification. Within the Administration, the results of the IG on U.S.-Soviet relations as well as the new information generated by CIA's SNIE on the Siberian pipeline should be used to develop policy on the entire range of East-West economic issues. Fundamental elements of the Administration policy should include:

(1) requesting U.S. banks to develop adequate loss reserves to cover a Polish default (the Kasten Amendment requiring the President to stop payment of CCC credits if private banks refuse to declare Poland in default was enacted as part of the FY 1982 Supplemental Appropriations Act. The President can continue to make payments, but he must certify to Congress that to do so is in the national security interests of the U.S.);

(2) adopting a clear policy regarding licensing of oil and gas equipment and technology to the USSR which would be implemented even if the situation in Poland improves;

(3) communicating, on the basis of new information, to Europeans, our strong security and moral objections to the pipeline as a prelude to insisting on limiting the pipeline to one strand; and

(4) making clear to our Allies that:

- we intend to enforce our regulations and may escalate the penalties if violations continue to occur, and
- any substitute package of sanctions will have to meet the twin criteria of effectiveness (e.g. restraining Soviet hard currency earnings and economic leverage over the West) and equity in burdensharing.

Classified by: L.J. Brady
Declassify on: OADR

SECRET

Step II -- Negotiations With Allies. The Europeans now appreciate the extent to which the U.S. is prepared to go to enforce Presidential decisions on oil and gas sanctions. Therefore, U.S. negotiators are in a strong position to achieve something meaningful in the East-West trade area, especially if we demonstrate flexibility on the sanctions.

The following could be the elements in an acceptable substitute package of sanctions:

The Europeans would agree to:

- Keep purchase of natural gas from Urengoy pipeline to minimum levels (30 BCM/yr.);
- Public assurances not to participate in any manner in construction or purchase of gas from a second pipeline strand;
- Adoption at October COCOM meeting of no exceptions policy on oil and gas technology and a narrow list of critical oil and gas equipment, (e.g. drilling/workover rigs capable below 15,000 feet, high pressure valves/blow-out preventors/Christmas trees, logging equipment, pipeline controls etc.);
- The negotiation of a set of rules to guide Alliance members trade with the East with view toward the formalization of COCOM as a treaty organization (would include establishing a COCOM secretariat, increasing the budget and modernizing the institution);
- Accept as a priority matter the major U.S. proposals now pending in COCOM for revision of the control list;
- Upgrading of an Economic Committee within NATO to regularly review strategic considerations relating to East-West trade, (e.g. subsidization of Soviet economy including level of credits, possible default of Poland, GDR etc.); and
- A phased in termination of all government guaranteed and subsidized credits to the USSR (a variant of this approach might be immediate termination of such credits for the USSR's nine defense priority industries).

The U.S. would agree to:

- Terminate the temporary denial orders and stop the investigations now underway against the three European firms (Creusot-Loire, Nuovo Pignone, and John Brown Engineering, and the one European U.S. subsidiary, Dresser-France);

- Allow firms with contracts signed before December 13, 1981, to honor such contracts (In the event that the USSR meets the three NATO Council conditions for the lifting of sanctions, oil and gas contracts signed after December 13, 1981 could be filled. The Alliance could also offer Poland a package of technical and financial assistance.);

- Push forward an Administration plan on energy alternatives to Siberian gas;

- Place strong emphasis and Presidential prestige on implementation of U.S. Middle East peace initiative.

CAMERON IRON WORKS

Cameron Iron Works, Inc. is a Houston based international steel company, engaged in the design, manufacture and marketing of a broad range of oil tools, ball valves, and forged steel products. Approximately 70% of their sales involve surface control equipment for the drilling and producing of oil gas wells. Cameron and its subsidiaries have melting and forging facilities in the U.S. and Scotland, and major oil tool manufacturing plants in Scotland, England, France, Germany, Singapore, Mexico, Argentina, Venezuela and Canada.

In March 1982, Cameron's German subsidiary obtained Soviet orders for oil and gas well drilling and production control equipment totalling approximately $100 million. The company maintains that none of it was destined for the Soviet Union to Western Europe pipeline.

The President's June sanction orders prohibits the export of oil and gas equipment by U.S.-owned foreign subsidiaries. Cameron's subsidiary now finds itself in an extremely difficult position for multiple reasons:

1. It will lose $100 million in sales if the contract is cancelled. Machinoimport/USSR has informed Cameron's subsidiary that it expected a reply by September 17, 1982, on whether shipments would start in July 1982, as specified under contract.

2. It faces substantial cancellation penalties totalling approximately $8 million.

3. Under the contract between Machinoimport/USSR and Cameron's subsidiary, the USSR can seek arbitration in Swedish courts. In addition to damages, Swedish law also provides for specific performance. The subsidiary will thus be faced with not only substantial cancellation penalties, but will most probably be forced to provide the equipment for which it has contracted.

4. Cameron's subsidiary may face other consequential and punitive damages by its subcontractors in France and Germany, who were to supply parts and services for the contracted equipment.

5. It has already invested approximately $15-20 million for production of the contracted equipment. If it cannot ship, it will be left with excess inventories which cannot be readily sold due to lack of demand, as well as wide availability of the equipment from alternate suppliers.

6. It is under strong pressure from the German Government to honor its current contract obligations.

7. The market for Cameron's products is highly competitive; they have worldwide competitors who are neither owned nor licensed by U.S. companies.

8. Currently, they have no procedures whereby they can appeal their case with the U.S. Government.

Although Cameron's dilemma is representative of similar problems confronting several U.S. companies, there is a particular urgency attendant on their situation. Their German subsidiary has been asked by Machinoimport to respond this week with a declaration as to whether or not they will fulfill the terms of the contract.

POTENTIAL EXCEPTIONS

COMPANY	EUROPEAN SUBSIDIARY	EQUIPMENT	VALUE	DESTINED FOR PIPELINE	RETROACTIVE
Geosource	Sensor, B.V. (Netherlands)	Geophones & Cables	$800,000	No	Yes
FMC Corp.	FMC Europe (France)	Spare parts oil field equipment	$300,000	No	Yes
Cameron Works	German Subsidiary	oil and gas drilling and production control equipment	$100M	No	Yes

Derived from public comments received in response to June 24, 1982, Federal Register notice of sanctions.